Uncertainty explains why Poloz won't be pinned down on rates

By Barrie McKenna
November 11, 2018 – *The Globe and Mail*

There are some things we know about Bank of Canada Governor Stephen Poloz.

He loves to talk about the economy in metaphors (from mushrooms and spaghetti sauce to trees and dog leashes). He doesn't take himself too seriously, once putting on a monster mask for a Halloween appearance at a parliamentary committee. And he hates spoon-feeding investors by laying out a clear path ahead for the bank's key interest rate.

So it was a bit of surprise that Mr. Poloz admitted in a recent speech in London that he spends a lot of time thinking about how investors may be gaming him. He said the bank closely monitors an obscure gauge – the overnight index swap market – to track where investors think the bank is headed on rates. While investors are looking for clues in every word and comma that comes out of the central bank, Mr. Poloz is apparently scrutinizing them just as closely for hints of a "disconnect" between their views and his own.

"We are generally reluctant to fine-tune market expectations about our interest-rate decisions through our communications," he said. "If we tried to guide market views so they were always aligned with our own, we would lose the cross-validation that financial markets provide." (In other words, the bank looks to the market for validation that its own analysis of where rates should be is correct.)

There may be another reason Mr. Poloz is so reluctant to provide the kind of rate guidance offered by the U.S. Federal Reserve and other central banks: The Bank of Canada is a lot less certain about the future than it lets on.

The Bank of Canada has made it clear in recent weeks that it wants to get the bank's main interest rate, now at 1.75 per cent, back up to the so-called "neutral" level of 2.5 per cent to 3.5 per cent. Neutral is the point where interest rates are neither slowing down the economy, nor revving up growth.

That's about as precise a target Mr. Poloz ever offers. In theory, that means the bank could still hike rates by up to another 1.75 percentage points over the next couple of years.

But, true to form, Mr. Poloz is playing it coy. In London, he said the neutral rate may actually be a moving target. The neutral rate, he told reporters, is "sufficiently uncertain" and "in principle, movable."

"All we know is that as we get closer to it, whatever it is, we'll begin to see signs that we're no longer stimulating demand," he explained.

In other words: We'll tell you we're in neutral when we get there.

Contrast that to the Fed. Every three months, it publicly releases a new projection of where its key rate – the federal funds rate – will be over the next three years, plus or minus 0.5 percentage points.

Interestingly, the Bank of Canada goes through a similar exercise. But unlike the Fed, it just doesn't share its projections with the public until years after the fact.

Last month, the bank offered the first of what will be a regular peek into its internal projections for rates, as well as for inflation, GDP growth and other indicators. But it is releasing the information with a five-year lag.

Laval University economist Stephen Gordon thinks he may know why the Bank of Canada is not eager to share this data in real time.

Based on an analysis of the newly released material, Mr. Gordon highlighted how consistently off-target the central bank was before and after the 2008-09 recession in projecting where its key interest rate would be.

For example, starting in the third quarter of 2011, Bank of Canada staff began anticipating a sharp upward slope for its key interest rate, eventually forecasting that it would reach more than 3 per cent by 2015. That never happened. Instead, the bank would cut rates twice in the face of the oil-price collapse, and rates remain well below that mark.

“Sometimes the Bank of Canada gets criticized for not providing enough forward guidance for interest rates to financial markets, but I think it’s just as well that the Bank keeps these projections to themselves,” he wrote in a recent blog post.

Many Bank of Canada watchers have often argued that Mr. Poloz should be more Fed-like by disclosing those rate projections. Mr. Gordon, however, cautioned that in Canada’s smaller financial markets, too much guidance might create more uncertainty, rather than less.

“The risk is that too many people would see it as a crutch and stop doing their own analysis,” he said in an interview.

Faced with an ever-changing landscape, the Bank of Canada is often wildly wrong about what level of interest rates will be needed over the medium term to keep the Canadian economy in balance, with stable, low inflation.

“This shows the bank doesn’t always know,” Mr. Gordon said. “Things happen.”